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Item 4 of the provisional agenda

ACCOUNTING BY SMALL AND MEDIUM-SIZED ENTERPRISES *

Report by the Ad Hoc Consultative Group of Experts on Accounting by Small and Medium-Sized Enterprises

* Submission of this document was delayed as a result of the need for further consultations with members of the ad hoc consultative groups.

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Guideline 8. Provisions

8.1 A provision should be recognized when:

(a) an enterprise has a *present obligation* (legal or constructive) as a result of a past event, excluding those arising from executory contracts, except where these are onerous;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognized.

Probable outflow of resources embodying economic benefits

8.2 For a liability to qualify for recognition, there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. For the purpose of this Guideline, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur (i.e. the probability that the event will occur is greater than the probability that it will not). Where it is not probable that a present obligation exists, an enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 8.19).

Reliable estimate of the obligation

8.3 The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which by their nature are more uncertain than most other balance sheet items. Except in extremely rare cases, an enterprise will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognizing a provision.

Contingent liabilities

8.4 An enterprise should not recognize a *contingent liability*.

8.5 A contingent liability is disclosed, as required by paragraph 8.19, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets

8.6 An enterprise should not recognize a *contingent asset.*

8.7 Contingent assets are not recognized in financial statements, since this may result in the recognition of income that may never be realized. However, when the realization of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.

8.8 A contingent asset is disclosed, as required by paragraph 8.20, where an inflow of economic benefits is probable.

Measurement

8.9 The amount recognized as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date.

Risks and uncertainties

8.10 Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgements under conditions of uncertainty, so that income or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.

8.11 The risks and uncertainties that inevitably surround many events and circumstances should be taken into account in reaching the best estimate of a provision.

8.12 Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision. Gains from the expected disposal of assets should not be taken into account when measuring a provision.

8.13 In the income statement, the expense relating to a provision may be presented net of the amount recognized for a reimbursement.

8.14 Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying

economic benefits will be required to settle the obligation, the provision should be reversed.

8.15 A provision should be used only for expenditures for which the provision was originally recognized.

8.16 Provisions should not be recognized for future operating losses.

8.17 If an enterprise has a contract that is onerous, the present obligation under the contract should be recognized and measured as a provision.

Disclosure

8.18 For each class of provision, an enterprise should disclose:

(a) the carrying amount at the beginning and end of the period; and

(b) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;

8.19 Unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable, an estimate of its financial effect, measured under paragraphs 8.9 and 8.10.

8.20 Where an inflow of economic benefits is probable, an enterprise should disclose a brief description of the nature of the contingent assets at the balance sheet date and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs 8.9 and 8.10.

8.21 Where any of the information required by paragraphs 8.19 and 8.20 is not disclosed because it is not practicable to do so, that fact should be stated.

8.22 In extremely rare cases, disclosure of some or all of the information required by paragraphs 8.18 to 8.20 can be expected to prejudice seriously the position of the enterprise in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an enterprise need not disclose the information but should disclose the general nature of the dispute, together with the fact that, and the reason why, the information has not been disclosed.

8.23 Examples of accounting for provisions are given in Appendix 2, part A.

Guideline 9. Revenue

Measurement of revenue

9.1 Revenue should be measured at the fair value of the consideration received or receivable.

Sale of goods

9.2 Revenue from the sale of goods should be recognized when all the following conditions have been satisfied:

(a) the enterprise has transferred to the buyer the significant risks and rewards of ownership of the goods;
(b) the enterprise retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
(c) the amount of revenue can be measured reliably;
(d) it is probable that the economic benefits associated with the transaction will flow to the enterprise; and
(e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Rendering of services

9.3 When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction should be recognized by reference to the stage of completion of the transaction at the balance sheet date. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

(a) the amount of revenue can be measured reliably;
(b) it is probable that the economic benefits associated with the transaction will flow to the enterprise;
(c) the stage of completion of the transaction at the balance sheet date can be measured reliably; and
(d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

9.4 When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue should be recognized only to the extent of the expenses recognized that are recoverable.

9.5 Goods include goods produced by the enterprise for the purpose of sale and goods purchased for resale, such as merchandise purchased by a retailer or land and other property held for resale.

9.6 The rendering of services typically involves the performance by the enterprise of a contractually agreed task over an agreed period of time. The services may be rendered within a single period or over more than one period. Some contracts for the rendering of services are directly related to *construction contracts* – for example, those for the services of project managers and architects.

9.7 Revenue includes only the gross inflows of economic benefits received and receivable by the enterprise on its own account. Amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value-added taxes are not economic benefits flowing to the enterprise and, hence, do not result in increases in equity. Therefore, they are excluded from revenue. Similarly, in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the enterprise. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission.

Interest, royalties and dividends

9.8 Revenue arising from the use by others of enterprise assets yielding interest, royalties and dividends should be recognized on the bases set out in paragraph 8.9 when:

(a) it is probable that the economic benefits associated with the transaction will flow to the enterprise; and
(b) the amount of the revenue can be measured reliably.

9.9 Revenue should be recognized on the following bases:

(a) interest should be recognized on a time proportion basis;
(b) royalties should be recognized on an accrual basis in accordance with the substance of the relevant agreement; and
(c) dividends should be recognized when the shareholder's right to receive payment is established.

9.10 Revenue is recognized only when it is probable that the economic benefits associated with the transaction will flow to the enterprise. However, when uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognized as an expense rather than as an adjustment of the amount of revenue originally recognized. Some examples of revenue recognition issues are given in Appendix 2, part B.

Disclosure

9.11 An enterprise should disclose:

(a) the accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services;

(b) the amount of each significant category of revenue recognized during the period, including revenue arising from:
   (i) the sale of goods;
   (ii) the rendering of services;
   (iii) interest;
   (iv) royalties; and
   (v) dividends; and

(c) the amount of revenue arising from exchanges of goods or services included in each significant category of revenue.

Guideline 10. Borrowing Costs

10.1 *Borrowing costs* may include:

(a) interest on bank overdrafts and short-term and long-term borrowings;
(b) amortization of ancillary costs incurred in connection with the arrangement of borrowings;
(c) finance charges in respect of finance leases; and
(d) *exchange differences* arising from *foreign currency* borrowings to the extent that they are regarded as an adjustment to interest costs.

Borrowing costs: benchmark treatment

10.2 Borrowing costs should be recognized as an expense in the period in which they are incurred.

Borrowing costs: allowed alternative treatment

Recognition

10.3 Borrowing costs should be recognized as an expense in the period in which they are incurred, except to the extent that they are capitalized in accordance with paragraph 10.4.

10.4 Borrowing costs that are directly attributable to the acquisition, construction or production of a *qualifying asset* should be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization should be determined in accordance with this Guideline.

10.5 Examples of qualifying assets are inventories that require a substantial period of time to bring them to a saleable condition, manufacturing plants, power generation facilities and investment properties. Other investments, and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets.

Borrowing costs eligible for capitalization

10.6 To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

10.7 To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization should be determined by applying a capitalization rate to the expenditures on that asset. The capitalization rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalized during a period should not exceed the amount of borrowing costs incurred during that period.

10.8 The capitalization of borrowing costs as part of the cost of a qualifying asset should commence when:

(a) expenditures for the asset are being incurred;
(b) borrowing costs are being incurred; and
(c) activities that are necessary to prepare the asset for its intended use or sale are in progress.

10.9 Capitalization of borrowing costs should be suspended during extended periods in which active development is interrupted.

10.10 Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

10.11 When the construction of a qualifying asset is completed in parts and each part is capable of being used while construction continues on other parts, capitalization of borrowing costs should cease when substantially all the activities necessary to prepare that part for its intended use or sale are completed.

Disclosure

10.12 The financial statements should disclose:

(a) the accounting policy adopted for borrowing costs;
(b) the amount of borrowing costs capitalized during the period; and
(c) the capitalization rate used to determine the amount of borrowing costs eligible for capitalization.

Guideline 11. Income Taxes

Current tax

11.1 *Current tax* for current and prior periods should, to the extent unpaid, be recognized as a liability. If the amount already paid in respect of current and prior periods exceeds the amount due for those periods, the excess should be recognized as an asset.

11.2 The benefit relating to a tax loss that can be carried back to recover current tax of a previous period should be recognized as an asset.

11.3 Current tax liabilities (assets) for the current and prior periods should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.

11.4 *Deferred tax assets* and *liabilities* may be recognized if the enterprise wishes to do so.

Income statement

11.5 Current tax should be recognized as income or an expense and included in the net profit or loss for the period, except to the extent that the tax arises from a transaction or event that is recognized other than in the income statement.

11.6 Current tax should be charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or a different period, directly to equity.

Presentation

11.7 Tax assets and tax liabilities should be presented separately from other assets and liabilities in the balance sheet. Deferred tax assets and liabilities, if recognized, should be distinguished from current tax assets and liabilities.

11.8 When an enterprise makes a distinction between current and non-current assets and liabilities in its financial statements, and has decided to account for deferred taxes, it should not classify deferred tax assets (liabilities) as current assets (liabilities).

11.9 An enterprise should offset current tax assets and current tax liabilities if, and only if, the enterprise:

(a) has a legally enforceable right to set off the recognized amounts; and

(b) intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Disclosure

11.10 The major components of tax expense (income) should be disclosed separately.

Guideline 12. Accounting Policies

12.1 Management should select and apply an enterprise's accounting policies so that the financial statements comply with all the requirements of the SMEGA. Where there is no specific requirement, management should look in turn to the following for guidance:

(a) full IFRS;
(b) interpretations;
(c) appendices to standards;
(d) implementation guidance;
(e) the definitions, recognition criteria and measurement concepts set out in the conceptual framework; and
(f) pronouncements of other standard setters that use a similar conceptual framework to develop accounting standards; other accounting literature; and accepted industry practice, to the extent that these are consistent with items (a) to (e) above.

Management should use its judgment in developing an accounting policy resulting in information that is relevant to the needs of investors and creditors and is reliable in nature.

Where management bases its accounting policy on IFRS, it should be guided by user needs in making disclosures. In such a case the entity is not then obliged to comply with the full IFRS, and should continue to describe itself in its accounting policy note as complying with the SMEGA.

12.2 An entity should select and apply its accounting policies for a period consistently for similar transactions, other events and circumstances, unless the Guideline elsewhere specifically requires or permits categorization of items for which different policies may be appropriate.

12.3 A change in accounting policy should be made only if it is required by the Guideline or if it results in a more relevant and reliable presentation in the financial statements of the effects of transactions or other events on the entity's financial position, financial performance or cash flows.

12.4 The following are not changes in accounting policies:

(a) the adoption of an accounting policy for transactions or other events that differ in substance from those previously occurring; and
(b) the adoption of a new accounting policy for transactions or other events that did not occur previously or were immaterial.

12.5 A change in an accounting policy that is made following an amendment to the Guideline should be accounted for in accordance with the transitional provisions, if any, issued with the Guideline.

12.6 Where application of a change in the Guideline has a material effect on the current period or any prior period presented, an entity should disclose the following:

(a) the fact that the change in accounting policy is made in accordance with the change in the Guideline, with a description of those provisions;
(b) the amount of the adjustment for the current period and for each prior period presented;
(c) the amount of the adjustment relating to periods prior to those included in the comparative information; and
(d) the fact that comparative information has been restated, or that restatement for a particular prior period has not been made because it would require undue cost and effort.

12.7 A change in an accounting policy other than one mandated under paragraph 12.5 should be applied retrospectively. The opening balance of retained earnings for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented should be adjusted, where applicable, as if the new accounting policy had always been in use.

12.8 Comparative information presented for a particular prior period need not be restated if restating the information would require undue cost or effort. When comparative information for a particular prior period is not restate ' the new accounting policy should be applied to the balances of assets and liabilities as at the beginning of the next period, and a corresponding adjustment should be made to the opening balance of retained earnings for the next period.

12.9 When a change in an accounting policy has an effect on the current period or any prior period presented, or may have an affect in subsequent periods, an entity should disclose the following:

(a) the reasons for the change;
(b) the amount of the adjustment for the current period and for each prior period presented;
(c) the amount of the adjustment relating to periods prior to those presented; and
(d) that comparative information has been restated, or that restatement for a particular prior period has not been made because it would require undue cost or effort.

Changes in accounting estimates

12.10 The effect of a change in an accounting estimate should be recognized prospectively by including it in profit or loss in:

(a) the period of the change, if the change affects that period only; or
(b) the period of the change and future periods, if the change affects both.

12.11 The nature and amount of a change in an accounting estimate that has an affect on the current period or is expected to have an effect in subsequent periods should be disclosed.

Errors

12.12 The amount of the correction of a fundamental error should be accounted for retrospectively. An error should be corrected by:

(a) either restating the comparative amounts for the prior periods in which the error occurred; or
(b) when the error occurred before the earliest prior period presented, restating the opening balance of retained earnings for that period, so that the financial statements are presented as if the error had never occurred.

12.13 Comparative information presented for a particular prior period need not be restated if restating the information would require undue cost or effort. When no restatement of comparative figures takes place, the opening balance of retained earnings for the next period should be restated for the cumulative effect of the error before the beginning of that period.

Disclosure

12.14 An entity should disclose:

(a) the nature of the error; and
(b) the amount of the correction for each prior period presented.

Guideline 13. Foreign Exchange Rates

Foreign currency transactions

13.1 A foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the *exchange rate* between the reporting currency and the foreign currency at the date of the transaction.

13.2 At each balance sheet date:

(a) foreign currency *monetary items* should be reported using the *closing rate;*
(b) non-monetary items that are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction; and
(c) non-monetary items that are carried at fair value denominated in a foreign currency should be reported using the exchange rate that existed when the values were determined.

13.3 Exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

Disclosure

13.4 An enterprise should disclose:

(a) the amount of exchange differences included in the net profit or loss for the period; and
(b) the amount of exchange differences arising during the period that is included in the carrying amount of an asset.

13.5 When the reporting currency is different from the currency of the country in which the enterprise is domiciled, the reason for using a different currency should be disclosed. The reason for any change in the reporting currency should also be disclosed.

Guideline 14. Events after Balance Sheet Date

14.1 An enterprise should adjust the amounts recognized in its financial statements to reflect adjusting events after the balance sheet date.

14.2 The following are examples of adjusting *events after the balance sheet date* that require an enterprise to adjust the amounts recognized in its financial statements, or to recognize items that were not previously recognized:

(a) the resolution after the balance sheet date of a court case which, because it confirms that an enterprise already had a present obligation at the balance sheet date, requires the enterprise to adjust a provision already recognized, or to recognize a provision instead of merely disclosing a contingent liability;

(b) the receipt of information after the balance sheet date indicating that an asset was impaired at the balance sheet date, or that the amount of a previously recognized impairment loss for that asset needs to be adjusted. For example:

(i) when the bankruptcy of a customer occurs after the balance sheet date, it usually confirms that a loss already existed at the balance sheet date on a trade receivable account and that the enterprise needs to adjust the carrying amount of the trade receivable account; and

(ii)the sale of inventories after the balance sheet date may give evidence about their net realizable value at the balance sheet date;

(c) the determination after the balance sheet date of the cost of assets purchased, or the proceeds from assets sold, before the balance sheet date;

(d) the determination after the balance sheet date of the amount of profit-sharing or bonus payments, if the enterprise had a present legal or *constructive obligation* at the balance sheet date to make such payments as a result of events before that date; and

(e) the discovery of fraud or errors indicating that the financial statements were incorrect.

14.3 An enterprise should not prepare its financial statements on a going concern basis if management determines, after the balance sheet date, either that it intends to liquidate the enterprise or to cease trading, or that it has no realistic alternative but to do so.

14.4 An enterprise should not adjust the amounts recognized in its financial statements to reflect non-adjusting events after the balance sheet date.

14.5 An example of a non-adjusting event after the balance sheet date is a decline in market value of investments between the balance sheet date and the date when the financial statements are authorized for issue. The fall in market value does not normally relate to the condition of the investments at the balance sheet date, but reflects circumstances that arise in the following period. Therefore, an enterprise does not adjust the amounts

recognized in its financial statements for the investments. Similarly, the enterprise does not update the amounts disclosed for the investments as at the balance sheet date, although it may need to give additional disclosure under paragraph 14.7.

14.6 If an enterprise receives information after the balance sheet date about conditions that existed at the balance sheet date, the enterprise should, in the light of the new information, update disclosures that relate to these conditions.

14.7 Where non-adjusting events after the balance sheet date are of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions, an enterprise should disclose the following information for each significant category of non-adjusting event after the balance sheet date:

(a) the nature of the event; and
(b) an estimate of its financial effect, or a statement that such an estimate cannot be made.

14.8 The following are examples of non-adjusting events after the balance sheet date that may be of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions:

(a) announcing a plan to discontinue an operation, disposing of assets or settling liabilities attributable to a discontinuing operation, or entering into binding agreements to sell such assets or settle such liabilities;
(b) major purchases and disposals of assets, or expropriation of major assets by government; and
(c) the destruction of a major production plant by a fire after the balance sheet date;

14.9 If dividends to holders of equity instruments are proposed or declared after the balance sheet date, an enterprise should not recognize those dividends as a liability at the balance sheet date.

14.10 An enterprise should disclose the date when the financial statements were authorized for issue and who gave that authorization. If the enterprise's owners or others have the power to amend the financial statements after issuance, the enterprise should disclose that fact.

Guideline 15. Related-Party Disclosures

15.1 This section deals only with those *related-party* relationships described in (a) to (d) below:

(a) enterprises that, either directly or indirectly through one or more intermediaries, are under common control with the reporting enterprise;

(b) individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them *significant influence* over the enterprise, and close members of the family of any such individual;

(c) key management personnel (i.e. those persons having authority and responsibility for planning, directing and controlling the activities of the reporting enterprise, including directors and officers of companies and close members of the families of such individuals); and

(d) enterprises in which a substantial interest in the voting power is owned, directly or indirectly, by any person described in (b) or (c) or over which such a person is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.

In considering each possible related-party relationship, attention is directed to the substance of the relationship, and not merely the legal form.

15.2 In the context of this Guideline the following are deemed not to be related parties:

(a) two companies simply because they have a director in common, notwithstanding paragraph 15.1 above (but it is necessary to consider the possibility, and to assess the likelihood, that the director would be able to affect the policies of both companies in their mutual dealings);

(b) (i) providers of finance;

(ii) trade unions;

(iii) public utilities; and

(iv) government departments and agencies, in the course of their normal dealings with an enterprise by virtue only of those dealings (although they may circumscribe the freedom of action of an enterprise or participate in its decision-making process); and

(c) a single customer, supplier, franchisor, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence.

Disclosure

15.3 The following are examples of situations where *related-party transactions* may lead to disclosures by a reporting enterprise in the period they affect:

(a) purchases or sales of goods (finished or unfinished);

(b) purchases or sales of property and other assets;

(c) rendering or receiving of services;

(d) agency arrangements;

(e) leasing arrangements;

(f) transfer of research and development;

(g) licence agreements;

(h) finance (including loans and equity contributions in cash or in kind);

(i) guarantees and collaterals; and

(j) management contracts.

15.4 Related-party relationships where control exists should be disclosed irrespective of whether there have been transactions between the related parties.

15.5 If there have been transactions between related parties, the reporting enterprise should disclose the nature of the related-party relationships as well as the types of transactions and the elements of the transactions necessary for an understanding of the financial statements.

15.6 The elements of transactions necessary for an understanding of the financial statements would normally include:

(a) an indication of the volume of the transactions, either as an amount or as an appropriate proportion;

(b) amounts or appropriate proportions of outstanding items; and

(c) pricing policies.

15.7 Items of a similar nature may be disclosed in aggregate except when separate disclosure is necessary for an understanding of the effects of related-party transactions on the financial statements of the reporting enterprise.

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Appendix 1. Definitions

Accounting policies are the specific principles, bases, conventions, rules and practices adopted by an enterprise in preparing and presenting financial statements.

Accounting profit is net profit or loss for a period before deduction of tax expenses.

An ***asset*** is a resource

(a) controlled by an enterprise as a result of past events; and
(b) from which future economic benefits are expected to flow to the enterprise.

An ***active market*** is a market where all the following conditions exist:

(a) the items traded within the market are homogeneous;
(b) willing buyers and sellers can normally be found at any time; and
(c) prices are available to the public.

Amortization is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds.

Carrying amount is the amount at which an asset is recognized in the balance sheet after deduction of any accumulated depreciation and accumulated impairment losses thereon.

Cash comprises cash on hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value.

Cash flows are inflows and outflows of cash and cash equivalents.

The ***closing rate*** is the spot exchange rate at the balance sheet date.

A ***construction contract*** is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

A ***constructive obligation*** is an obligation that derives from an enterprise's actions where,

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the enterprise has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the enterprise has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

A ***contingent asset*** is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

A ***contingent liability*** is

(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(b) a present obligation that arises from past events but is not recognized because

(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) the amount of the obligation cannot be measured with sufficient reliability.

Control is ownership, either directly or indirectly through subsidiaries, of more than one half of the voting power of an enterprise, or a substantial interest in voting power and the power to direct, by statute or agreement, the financial and operating policies of the management of the enterprise.

Contingent rent is that portion of the lease payments which is not fixed in amount but is based on a factor other than the passage of time (e.g. percentage of sales, amount of usage, price indices, market rates of interest).

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition, production or construction.

Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

Deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences.

Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of

(a) deductible temporary differences;

(b) the carry forward of unused tax losses; and

(c) the carry forward of unused tax credits.

Depreciable amount is the cost of an asset, or other amount substituted for cost in the financial statements, less its residual value.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

Economic life is either

(a) the period over which an asset is expected to be economically usable by one or more users; or

(b) the number of production or similar units expected to be obtained from the asset by one or more users.

Events after the balance sheet date are events, both favourable and unfavourable, that occur between the balance sheet date and the date when the financial statements are authorised for issue. Two types of events can be identified:

(a) those providing evidence of conditions that existed at the balance sheet date (adjusting events after the balance sheet date); and

(b) those indicative of conditions that arose after the balance sheet date (non-adjusting events after the balance sheet date).

The ***exchange difference*** is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.

The ***exchange rate*** is the ratio for exchange of two currencies.

Extraordinary items are income or expenses arising from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly.

The ***fair value*** of an asset is the amount for which an asset could be exchanged, or a liability settled, between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's-length transaction.

A ***finance lease*** is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred.

Financing activities are activities that result in changes in the size and composition of the equity capital and borrowings of the enterprise.

Foreign currency is a currency other than the reporting currency of an enterprise.

Forgivable loans are loans that the lender undertakes to waive repayment of under certain prescribed conditions.

Fundamental errors are errors discovered in the current period that are of such significance that the financial statements of one or more prior periods can no longer be considered to have been reliable at the date of their issue.

Government refers to government, government agencies and similar bodies, whether local, national or international.

Government assistance is action by government designed to provide an economic benefit specific to an enterprise or range of enterprises qualifying under certain criteria. Government assistance for the purpose of this Guideline does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.

Government grants are assistance by government in the form of transfers of resources to an enterprise in return for past or future compliance with certain conditions relating to the operating activities of the enterprise. They exclude those forms of government assistance which cannot reasonably have a value placed on them and transactions with government which cannot be distinguished from the normal trading transactions of the enterprise.

Grants related to assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

Grants related to income are government grants other than those related to assets.

Guaranteed residual value is,

(a) in the case of the lessee, that part of the residual value which is guaranteed by the lessee or by a party related to the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and

(b) in the case of the lessor, that part of the residual value which is guaranteed by the lessee or by a third party unrelated to the lessor who is financially capable of discharging the obligations under the guarantee.

Historical Cost assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

An ***impairment loss*** is the amount by which the carrying amount of an asset exceeds its recoverable amount.

The ***inception*** of the lease is the earlier of the date of the lease agreement or the date of a commitment by the parties to the principal provisions of the lease.

The lessee's ***incremental borrowing rate of interest*** is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

An ***intangible asset*** is an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

The ***interest rate implicit in the lease*** is the discount rate that, at the inception of the lease, causes the aggregate present value of

(a) the minimum lease payments; and
(b) the unguaranteed residual value to be equal to the fair value of the leased asset.

Inventories are assets

(a) held for sale in the ordinary course of business;
(b) in the process of production for such sale; or
(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

A ***lease*** is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

The ***lease term*** is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease

the asset, with or without further payment, which option at the inception of the lease it is reasonably certain that the lessee will exercise.

A ***legal obligation*** is an obligation that derives from

(a) a contract (through its explicit or implicit terms);
(b) legislation; or
(c) other operation of law.

A ***liability*** is a present obligation of an enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

Minimum lease payments are the payments over the lease term that the lessee is, or can be required, to make, excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with,
in the case of the lessee, any amounts guaranteed by the lessee or by a party related to the lessee. However, if the lessee has an option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable, and if, at the inception of the lease, it is reasonably certain that the option will be exercised, then the minimum lease payments comprise the minimum payments payable over the lease term and the payment required to exercise this purchase option.

Monetary assets are money held and assets to be received in fixed or determinable amounts of money.

Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

A ***non-cancellable lease*** is a lease that is cancellable only

(a) upon the occurrence of some remote contingency;
(b) with the permission of the lessor;
(c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or
(d) upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.

An ***obligating event*** is an event that creates a legal or constructive obligation that results in an enterprise's having no realistic alternative to settling that obligation.

An ***onerous contract*** is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

Operating activities are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.

An ***operating lease*** is a lease other than a finance lease.

Ordinary activities are any activities undertaken by an enterprise as part of its business and related activities in which the enterprise engages in furtherance of, incidental to, or arising from these activities.

Property, plant and equipment are tangible assets that

(a) are held by an enterprise for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than one period.

A ***provision*** is a liability of uncertain timing or amount.

A ***qualifying asset*** is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Related party: Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions.

A ***related-party transaction*** is a transfer of resources or obligations between related parties, regardless of whether a price is charged.

Reporting currency is the currency used in presenting the financial statements.

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Residual value is the net amount an enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.

Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an enterprise when those inflows result in increases in equity, other than increases relating to contributions from equity participants.

Significant influence is (for the purpose of SMEGA) participation in the financial and operating policy decisions of an enterprise without having control of those policies. Significant influence may be exercised in several ways, usually by representation on the board of directors but also by, for example, participation in the policy-making process, material intercompany transactions, interchange of managerial personnel or dependence on technical information.

The ***tax base*** of an asset or liability is the amount attributed to that asset or liability for tax purposes.

Tax expense (tax income) is the aggregate amount included in the determination of net profit or loss for the period in respect of current tax and deferred tax.

Taxable profit (tax loss) is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, on which income taxes are payable (recoverable).

Temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either

(a) *taxable temporary differences*, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or

(b) *deductible temporary differences*, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

Useful life is either

(a) the period of time over which an asset is expected to be used by the enterprise; or

(b) the number of production or similar units expected to be obtained from the asset by the enterprise.

Appendix 2. Examples

A. Recognition of provisions

Example 1: Warranties

A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale, the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. Based on past experience, it is probable (i.e. more likely than not) that there will be some claims under the warranties.

Present obligation as a result of a past obligating event: The obligating event is the sale of the product with a warranty, which gives rise to a *legal obligation.*

An outflow of resources embodying economic benefits in settlement: Probable for the warranties as a whole.

Conclusion: A provision is recognized for the best estimate of the costs of making good under the warranty products sold before the balance sheet date.

Example 2: Legal Requirement to Fit Smoke Filters

Under new legislation, an enterprise is required to install smoke filters in its factories by 30 June 2000. The enterprise has not fitted the smoke filters

.

(a) At the balance sheet date of 31 December 1999:

Present obligation as a result of a past obligating event: There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.

Conclusion: No provision is recognized for the cost of fitting the smoke filters.

(b) At the balance sheet date of 31 December 2000:

Present obligation as a result of a past obligating event: There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).

An outflow of resources embodying economic benefits in settlement: The likelihood of incurring fines and penalties for non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.

Conclusion: No provision is recognized for the costs of fitting smoke filters. However, a provision is recognized for the best estimate of any fines and penalties that are more likely than not to be imposed.

Example 3: A Court Case

After a wedding in 2000, 10 people died, possibly as a result of food poisoning from products sold by the enterprise. Legal proceedings are underway seeking damages from the enterprise, but it disputes its liability. Up to the date of approval of the financial statements for the year to 31 December 2000 for issue, the enterprise's lawyers advise that it is probable that the enterprise will not be found liable. However, when the enterprise prepares the financial statements for the year ending 31 December 2001, its lawyers advise that, because of new developments in the case, it is probable that the enterprise will be found liable.

(a) At the balance sheet date of 31 December 2000:

Present obligation as a result of a past obligating event: On the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.

Conclusion: No provision is recognized. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

(b) At the balance sheet date of 31 December 2001:

Present obligation as a result of a past obligating event: On the basis of the evidence available, there is a present obligation.

An outflow of resources embodying economic benefits in settlement: Probable.

Conclusion: A provision is recognized for the best estimate of the amount required to settle the obligation.

Example 4: Refurbishment Costs – No Legislative Requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. At the balance sheet date, the lining has been in use for three years.

Present obligation as a result of a past obligating event: There is no present obligation.

Conclusion: No provision is recognized.

The cost of replacing the lining is not recognized because, at the balance sheet date, no obligation to replace the lining exists independently of the company's future actions; even the intention to incur the expenditure depends on the company's deciding to continue operating

the furnace or to replace the lining. Instead of a provision being recognized, the depreciation of the lining takes into account its consumption (i.e. it is depreciated over five years). The relining costs then incurred are capitalized, with the consumption of each new lining shown by depreciation over the subsequent five years.

B. Revenue recognition

The following examples illustrate the application of the SMEGA in a number of commercial situations in order to clarifying their meaning. The examples focus on particular aspects of a transaction and do not constitute comprehensive discussions of all the relevant factors that might influence the recognition of revenue. The examples generally assume that the amount of revenue can be measured reliably; that it is probable that the economic benefits will flow to the enterprise; and that the costs incurred or to be incurred can be measured reliably. The examples do not modify or override the standard.

Sale of goods

Since laws vary from country to country, the recognition criteria in this standard will be met at different times. In particular, the law may determine the point in time at which the enterprise transfers the significant risks and rewards of ownership. Therefore, the examples in this section of the appendix need to be read in the context of the laws relating to the sale of goods in the country in which the transaction takes place.

1. *"Bill and hold2 sales, in which delivery is delayed at the buyer's request but the buyer takes title and accepts billing.*

   Revenue is recognized when the buyer takes title, provided:
   (a) it is probable that delivery will be made;
   (b) the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognized;
   (c) the buyer specifically acknowledges the deferred delivery instructions; and
   (d) the usual payment terms apply.

   Revenue is not recognized when there is simply an intention to acquire or manufacture the goods in time for delivery.

2. *Goods shipped subject to conditions, including the following situations:*
   (a) *Installation and inspection.*
   Revenue is normally recognized when the buyer accepts delivery and installation and inspection are complete. However, revenue is recognized immediately upon the buyer's acceptance of delivery when:
   (i) the installation process is simple in nature (e.g. the installation of a factory-tested television receiver which only requires unpacking and connection of power and antennae); or

(ii) the inspection is performed only for purposes of final determination of contract prices (e.g. for shipments of iron ore, sugar or soya beans).

(b) *On approval when the buyer has negotiated a limited right of return.*
If there is uncertainty about the possibility of return, revenue is recognized when the shipment has been formally accepted by the buyer or the goods have been delivered and the time period for rejection has elapsed.

(c) *Consignment sales under which the recipient (buyer) undertakes to sell the goods on behalf of the shipper (seller).*
Revenue is recognized by the shipper when the goods are sold by the recipient to a third party.

(d) *Cash on delivery sales.*

Revenue is recognized when delivery is made and cash is received by the seller or its agent.

3. *Layaway sales, in which the goods are delivered only when the buyer makes the final payment in a series of instalments.*
Revenue from such sales is recognized when the goods are delivered. However, when experience indicates that most such sales are consummated, revenue may be recognized when a significant deposit is received provided the goods are on hand, identified and ready for delivery to the buyer.

4. *Orders in which payment (or partial payment) is received in advance of delivery for goods not presently held in inventory (e.g. the goods are still to be manufactured or will be delivered directly to the customer from a third party).*
Revenue is recognized when the goods are delivered to the buyer.

5. *Sale and repurchase agreements (other than swap transactions) under which the seller concurrently agrees to repurchase the same goods at a later date, or when the seller has a call option to repurchase, or the buyer has a put option to require the repurchase by the seller of the goods.*
The terms of the agreement need to be analysed to ascertain whether, in substance, the seller has transferred the risks and rewards of ownership to the buyer and hence revenue is recognized. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue.

6. *Sales to intermediate parties, such as distributors, dealers or others, for resale.*
Revenue from such sales is generally recognized when the risks and rewards of ownership have passed. However, when the buyer is acting, in substance, as an agent, the sale is treated as a consignment sale.

7. *Subscriptions to publications and similar items.*

When the items involved are of similar value in each time period, revenue is recognized on a straight line basis over the period in which the items are despatched. When the items vary in value from period to period, revenue is recognized on the basis of the sales value of the item despatched in relation to the total estimated sales value of all items covered by the subscription.

8. *Instalment sales, under which the consideration is receivable in instalments.*
Revenue attributable to the sales price, exclusive of interest, is recognized at the date of sale. The sale price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The interest element is recognized as revenue as it is earned, on a time proportion basis that takes into account the imputed rate of interest.

9. *Real estate sales.*
Revenue is normally recognized when legal title passes to the buyer. However, in some jurisdictions the equitable interest in a property may vest in the buyer before legal title passes and, therefore, the risks and rewards of ownership have been transferred at that stage. In such cases, provided that the seller has no further substantial acts to complete under the contract, it may be appropriate to recognize revenue. In either case, if the seller is obliged to perform any significant acts after the transfer of the equitable and/or legal title, revenue is recognized as the acts are performed. An example is a building or other facility on which construction has not been completed.
In some cases, real estate may be sold with a degree of continuing involvement by the seller such that the risks and rewards of ownership have not been transferred. Examples are sale and repurchase agreements that include put and call options, and agreements whereby the seller guarantees occupancy of the property for a specified period, or guarantees a return on the buyer's investment for a specified period. In such cases, the nature and extent of the seller's continuing involvement determine how the transaction is accounted for. It may be accounted for as a sale, or as a financing, a leasing or some other profit-sharing arrangement. If it is accounted for as a sale, the continuing involvement of the seller may delay the recognition of revenue.

A seller must also consider the means of payment and evidence of the buyer's commitment to complete payment. For example, when the aggregate of the payments received, including the buyer's initial down payment or continuing payments by the buyer, provide insufficient evidence of the buyer's commitment to complete payment, revenue is recognized only to the extent that cash is received.

Rendering of services

10. *Installation fees.*
Installation fees are recognized as revenue by reference to the stage of completion of the installation, unless they are incidental to the sale of a product, in which case they are recognized when the goods are sold.

11. *Servicing fees included in the price of the product.*
When the selling price of a product includes an identifiable amount for subsequent servicing (e.g. after sales support and product enhancement on the sale of software), that amount is deferred and recognized as revenue over the period during which the service is performed. The amount deferred is that which will cover the expected costs of the services under the agreement, together with a reasonable profit on those services.

12. *Advertising commissions.*
Media commissions are recognized when the related advertisement or commercia. appears before the public. Production commissions are recognized by reference to the stage of completion of the project.

13. *Insurance agency commissions.*
Insurance agency commissions received or receivable that do not require the agent to render further service are recognized as revenue by the agent on the effective commencement or renewal dates of the related policies. However, when it is probable that the agent will be required to render further services during the life of the policy, the commission, or part thereof, is deferred and recognized as revenue over the period during which the policy is in force.

14. *Admission fees.*
Revenue from artistic performances, banquets and other special events is recognized when the event takes place. When a subscription to a number of events is sold, the fee is allocated to each event on a basis that reflects the extent to which services are performed at each event.

15. *Tuition fees.*
Revenue is recognized over the period of instruction.

16. *Initiation, entrance and membership fees.*
Revenue recognition depends on the nature of the services provided. If the fee permits only membership, and all other services or products are paid for separately, or if there is a separate annual subscription, the fee is recognized as revenue when no significant uncertainty as to its collectability exists. If the fee entitles the member to services or publications to be provided during the membership period, or to the purchase of goods or services at prices lower than those charged to nonmembers, it is recognized on a basis that reflects the timing, nature and value of the benefits provided.

17. *Franchise fees.*
Franchise fees may cover the supply of initial and subsequent services, equipment and other tangible assets, and know-how. Accordingly, franchise fees are recognized as revenue on a basis that reflects the purpose for which the fees were charged. The following methods of franchise fee recognition are appropriate:

(a) Supplies of equipment and other tangible assets.
The amount, based on the fair value of the assets sold, is recognized as revenue when the items are delivered or title passes.

(b) Supplies of initial and subsequent services.
Fees for the provision of continuing services, whether part of the initial fee or a separate fee are recognized as revenue as the services are rendered. When the separate fee does not cover the cost of continuing services together with a reasonable profit, part of the initial fee, sufficient to cover the costs of continuing services and to provide a reasonable profit on those services, is deferred and recognized as revenue as the services are rendered.

The franchise agreement may provide for the franchisor to supply equipment, inventories, or other tangible assets at a price lower than that charged to others or a price that does not provide a reasonable profit on those sales. In these circumstances, part of the initial fee, sufficient to cover estimated costs in excess of that price and to provide a reasonable profit on those sales, is deferred and recognized over the period during which the goods are likely to be sold to the franchisee. The balance of an initial fee is recognized as revenue when performance of all the initial services and other obligations required of the franchisor (e.g. assistance with site selection, staff training, financing and advertising) has been substantially accomplished.

The initial services and other obligations under an area franchise agreement may depend on the number of individual outlets established in the area. In this case, the fees attributable to the initial services are recognized as revenue in proportion to the number of outlets for which the initial services have been substantially completed.

If the initial fee is collectable over an extended period and there is a significant uncertainty that it will be collected in full, the fee is recognized as cash instalments are received.

(c) *Continuing franchise fees.*
Fees charged for the use of continuing rights granted by the agreement, or for other services provided during the period of the agreement, are recognized as revenue as the services are provided or the rights used.

(d) *Agency transactions.*
Transactions may take place between the franchisor and the franchisee which, in substance, involve the franchisor's acting as agent for the franchisee. For example, the franchisor may order supplies and arrange for their delivery to the franchisee at no profit. Such transactions do not give rise to revenue.

19. *Fees from the development of customized software.*
Fees from the development of customized software are recognized as revenue by reference to the stage of completion of the development, including completion of services provided for post-delivery service support.

Interest, royalties and dividends

20. *Licence fees and royalties.*
Fees and royalties paid for the use of an enterprise's assets (e.g. trademarks, patents, software, music copyright, record masters and motion picture films) are normally recognized in accordance with the substance of the agreement. As a practical matter, this may be on a straight line basis over the life of the agreement – for example, when a licensee has the right to use certain technology for a specified period of time.

An assignment of rights for a fixed fee or nonrefundable guarantee under a noncancellable contract that permits the licensee to exploit those rights freely such that the licensor has no remaining obligations to perform is, in substance, a sale. An example is a licensing agreement for the use of software when the licensor has no obligations subsequent to delivery. Another example is the granting of rights to exhibit a motion picture film in markets where the licensor has no control over the distributor and expects to receive no further revenues from the box office receipts. In such cases, revenue is recognized at the time of sale.

In some cases, whether or not a licence fee or royalty will be received is contingent on the occurrence of a future event. In such cases, revenue is recognized only when it is probable that the fee or royalty will be received, which is normally when the event has occurred.

Appendix 3. Source Material

The SMEGA for Level 2 SMEs are drawn from *International Accounting Standards and Interpretations*. The standards that have been included are:

SMEGA	IAS	Comments
1	1	
2	7	
3	16, 36	The SMEGA for Level 2 include impairment guidance but do not follow IAS 36 measurement rules. SIC 10 is also included.
4	17	SIC 15 is included.
5	38	
6	2	
7	20	
8	37	Discounting of provisions is not required.
9	18	
10	23	
11	12	
12	8	This version takes into account modifications proposed in the IASB exposure draft of May 2002.
13	21	
14	10	
15	24	

The SMEGA for Level 2 do not include the following standards:

11	Construction contracts
14	Segment reporting
19	Employee benefits
22	Business combinations
26	Accounting and reporting by retirement benefit plans
27	Consolidated financial statements
28	Accounting for investments in associates
29	Financial reporting in hyperinflationary economies
30	Disclosures in the financial statements of banks
31	Financial reporting of interests in joint ventures
32	Financial instruments: disclosure and presentation
33	Earnings per share
34	Interim financial reporting

35	Discontinuing operations
39	Financial instruments: recognition and measurement
40	Investment property
41	Agriculture

Appendix 4. Members of the Ad Hoc Consultative Group on Accounting by SMEs[1]

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